THE TRENDS + MARKETS TO WATCH 2016
INDUSTRIAL

SVN COMMERCIAL REAL ESTATE ADVISORS

# INDUSTRIAL Market Outlook

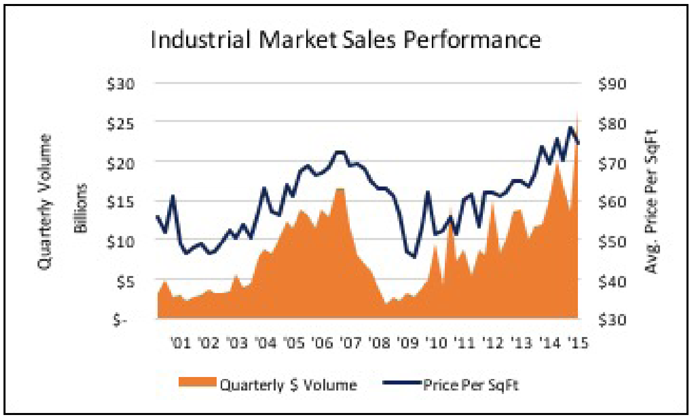
## GLOBAL PRESSURES WEIGH ON GROWTH

Industrial real estate made significant progress in 2015 as nationwide vacancies fell to 8.5%, a level not seen since 2000 according to commercial real estate research firm REIS®. This is the result of a steady, consistently growing economy that has set new records in GDP almost every year since the end of the recession. At the start of 2016, there is ever-growing concern that economic declines and slow growth in markets like Asia and Europe will cause declines in domestic manufacturing and trade operations. Thus, this sector will face unique risks in the coming years.

While global risks are topical discussions today, 2015 was an all-time record year for industrial real estate transactions, according to Real Capital Analytics® (RCA), who reported over $77.5 billion in deals closing with an average cap rate of 6.8%. This represents a 55% increase from 2014; however, much of these gains came from the hot warehouse market which grew by 65% in 2014 compared with 30% in flex according to RCA. Warehouse also held an edge in average cap rates of 6.7% versus 7.0% for flex. Given that trade and manufacturing could be impacted in 2016, it is uncertain if these sales records will be repeated this year; still, yield seeking investors are likely to desire industrial real estate given the low interest rate environment forecast to persist for the near term.

Where growth is most likely to occur in the industrial real estate market is in properties that are part of the domestic supply chain, especially those involved in goods manufacturing and delivery to consumers. The US has record employment and is starting to reinvest in everything from business equipment to housing; these activities often spur demand for industrial space.

The greatest source of weakness likely in 2016 are properties and markets serving the oil and gas industry. The price declines in 2015 appear to be at least somewhat persistent and it is almost inevitable that investments into this sector will be reduced; especially with regards to new exploration. Of course, low energy prices help lower transit and production costs of many goods so the effect is somewhat moderated on a nationwide basis. Each market will be a relative "winner" or "loser" based on its production versus consumption of energy products.




Source: Real Capital Analytics®, Lakemont Group

**MARKETS TO WATCH**

- ALBUQUERQUE
- CHICAGO
- DALLAS
- GREENVILLE-SPARTANBURG
- KNOXVILLE
- LOS ANGELES
- MEMPHIS
- PITTSBURGH
- SEATTLE
- ST. LOUIS

## Economic Projections - Industrial

- GDP Growth
- New Orders
- Corp. Profits
- Construct Emp.
- Retail Sales
- Interest Rates

## Real Estate Market Projections - Industrial

- Rental Rates
- Occupancy
- Prices
- New Construction
- Net Absorbtion
- Transaction Vol.

# Industrial Market Statistics

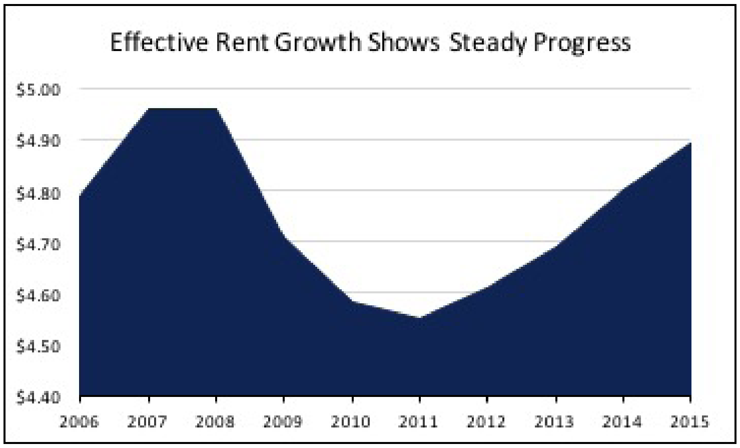
## NET ABSORPTION STRONG AS VACANCY FALLS

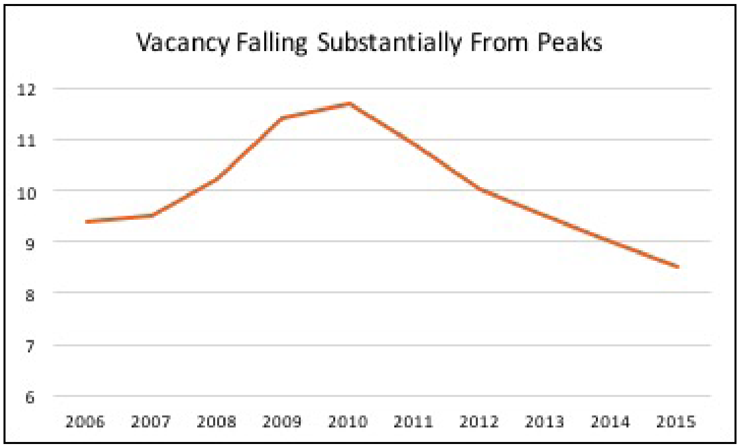
Overall effective rents for industrial space grew 2.2% for 2015 and have averaged above 2% since 2013, according to REIS®. This steady, persistent growth has brought the nationwide effective rent average up to $4.89 per square foot which is just slightly behind the all-time record highs of 2007 at $4.96 per square foot. Rent growth is projected by REIS® to remain above 2% and even get close to 3% for the next five years; but global pressures that began in early 2016 may have a moderating impact. Still, it is highly likely that rents will grow at some modest pace for the foreseeable future.

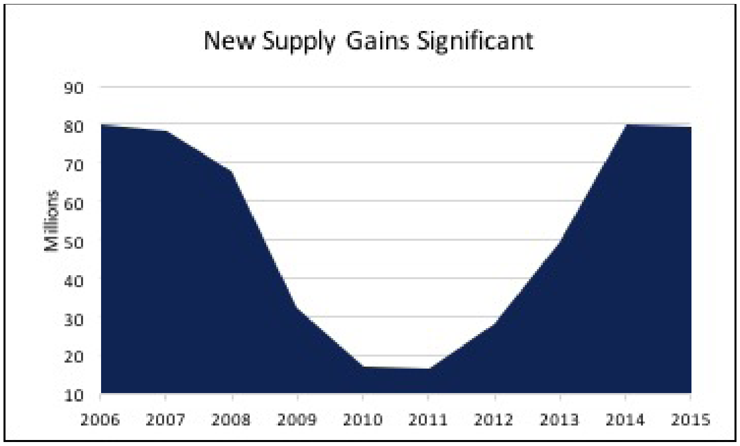
More impressive are the declines in the vacancy rate which now sits at 8.5% at the end of 2015. This is due to the robust level of net absorption across the nation. REIS® reports that over 119.4 million square feet of industrial space was absorbed in 2015, compared to just 79.7 million square feet of new space additions. If similar rates of net absorption persist, as some forecast they will, there is a strong likelihood of fast growing rental rates. This is critical to observe, as even if a global demand decline takes hold, the current supply and demand balance in the industrial space market is so tilted towards undersupply that landlords may see increases in rents and net operating incomes regardless.

The rate of new supply completions has increased dramatically from post-recession lows (79.6 million square feet in 2015 compared to 28.0 million square feet in 2012), but is still well below the +100 million square feet levels seen prior to 2000. Thus, there likely exists many opportunities for entrepreneurial developers seeking to build speculative space. If one correctly picks the market and property type, they may likely experience above average returns given the risk.

Industrial markets that service large growing population bases are the types that are most in line for growth in fundamentals and values. Speed and efficiency in delivery and supply chains dictate that firms must have many warehouses and distribution hubs close to their customers if they wish to compete. The natural result is greater overall demand for industrial space. Markets that are concentrated on one or two key industries to support industrial space demand as well as the employment base are the ones most at risk to external demand shocks.




Source: REIS®, Lakemont Group

# Industrial Market Statistics

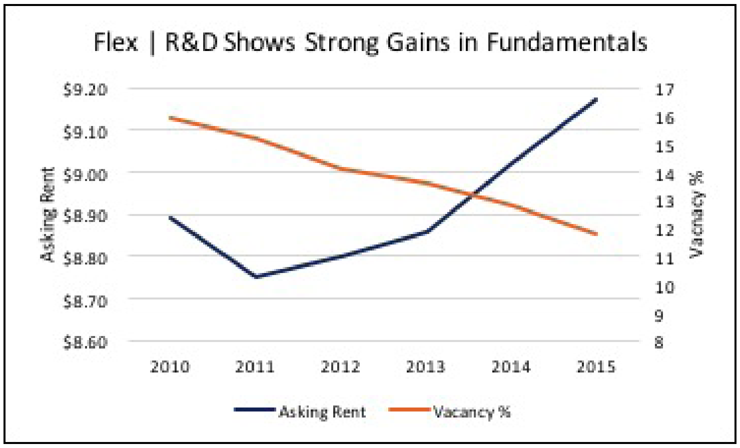
## FUNDAMENTALS IMPROVE FOR ALL INSUTRIAL SECTORS

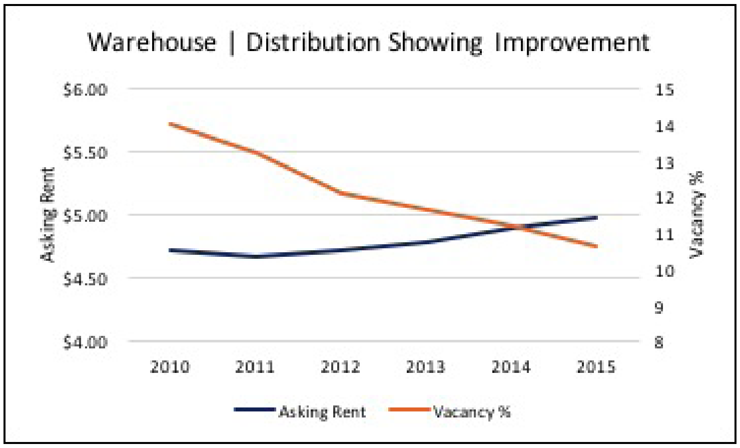
Industrial real estate has the most segmented use types of any property type and thus can have very different dynamics accordingly. Flex/Research & Development (R&D) space has experienced persistent gains in effective rents, averaging over 1.6% since 2012, (1.9% in 2015) according to REIS®. Vacancy in this sub-segment has also fallen to 11.8% from highs of almost 16% during the recession. Given the level of core economic growth and business investment, these trends are likely to continue for 2016 and longer.

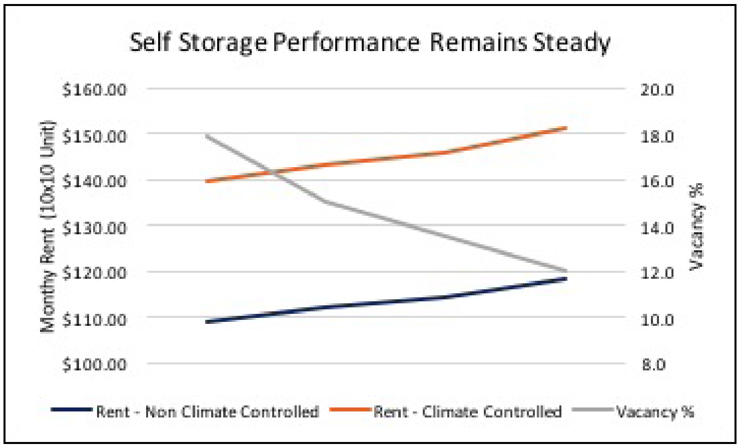
Warehouse and distribution space has performed even better with average effective rents growing at 2.0% in 2015 and averaging over 2% since 2012. Additionally, vacancy has fallen to 10.6% in 2015 from highs of 14.0% in 2010. As discussed herein, this segment is perhaps the best positioned to grow in the coming years as more and more firms need to diversify and grow their supply and distribution chains.

From a net absorption standpoint, Flex/R&D showed the greatest supply imbalance, with 14.9 million square feet being absorbed with only 3.7 million square feet being completed in 2015. Warehouse and distribution absorbed 99.1 million square feet versus new supply of 69.6 million square feet over the same time period. However, the vacant stock of Flex/R&D is still significant, thus major amounts of new supply of this product type are not likely needed as of today.

Self storage is a specialized type of industrial real estate that demands attention as more and more investors acquire it for their portfolios. REIS® reports that monthly rents of both climate controlled and non-climate controlled units have been growing consistently since 2011; 4.3% and 3.2% in 2015, respectively. Vacancies have also been falling from a recessionary high of 17.9% in 2011 to 11.2% by the end of 2015. Rents are further expected to grow for both types with slowly falling occupancy for the next few years. As supply of this asset type can fluctuate faster than for other types of industrial real estate, investors need to pay attention to construction trends in their individual markets to assess the likelihood of improving or declining performance in 2016 and beyond.




Source: REIS®, Lakemont Group

# Industrial Economic Statistics

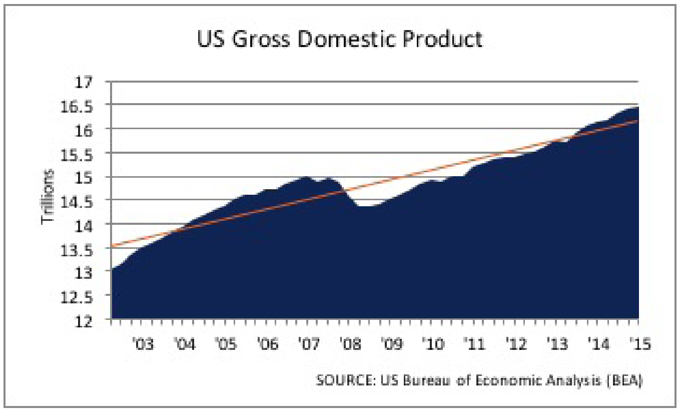
## DEMAND GROWTH PERSISTS

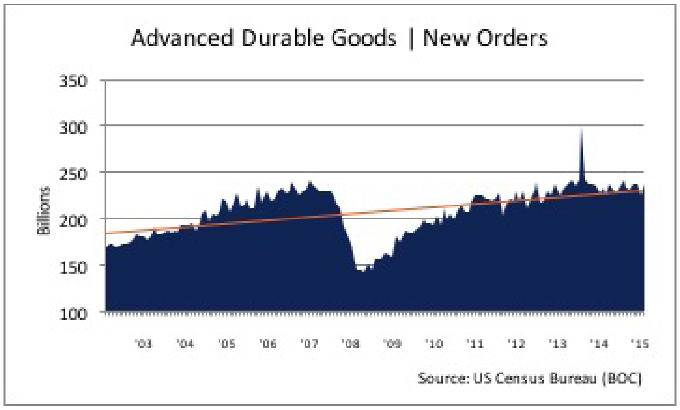
The core economic engine of the United States has been producing consistent, steady gains in demand and output and as such has been fueling the rising levels of fundamentals in the industrial real estate market. Gross Domestic Product, the overall measure of domestic output, has grown steadily since the recession and has managed to produce a new record high almost every quarter. When combined with all-time record high levels of total employment and historically low interest rates, this nation has a relatively very healthy consumer sector that can buy a vast amount of goods and services. This benefits a large number of industrial space-using firms and sectors.

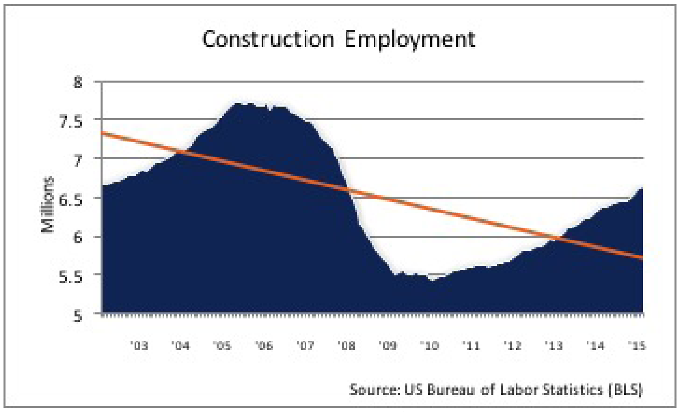
Manufacturing activity in the United States, a core demand driver for industrial real estate, has not been growing as actively on a relative basis. New orders of durable goods, a core measure of domestic manufacturing output, is graphically depicted herein and shows that levels of new orders have more or less reached pre-recession levels, but have failed to show persistent growth. Worse, this sector is the most vulnerable to global economic slowdown, especially with a strong US dollar, which has been the case in 2016. Thus, it is logical to project slow, and even negative growth in some markets where industrial real estate primarily services the manufacturing sector. Where manufacturing is flourishing in the United States is in states and regions without unions or in high-tech sectors that employ highly specialized labor. These industries do not use large volumes of industrial space like heavy goods producers typically do.

The biggest bright spot for future growth in industrial demand is from construction activities and related industries. The United States is starting to experience a construction boom in both residential and non-residential as evidenced graphically by the recovery in construction sector employment. Construction activity requires the production of materials, localized delivery of supplies and equipment, as well as further stimulation of durable goods such as furnishings, appliances, and electronics after construction is complete. Further, much of this activity cannot be offshored efficiently and thus local industrial facilities are almost always stimulated by building activity.

Since global market jitters help to keep interest rates low and low interest rates stimulate construction activity, this is the natural counter acting benefit that the industrial space market needs to maintain growth and stability in 2016 and beyond.



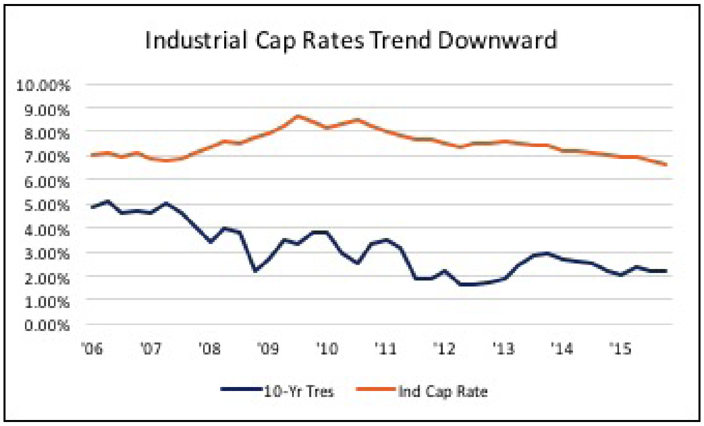



# Industrial Capital Markets Outlook

## YIELD SEEKING INVESTORS DISCOVER INDUSTRIAL PROPERTIES

Following the recession, institutional investors quickly looked to multifamily assets to deploy capital and then expanded into office properties as the recovery took hold. Industrial real estate, which is naturally more recession resistant, has yet to become the main focus of acquisition officers and fund managers. However, this appears to be changing as dollar volume of industrial transactions grew 55% year over year in 2015 with cap rates falling to an average of 6.8%, according to Real Capital Analytics®. This appears to be as much of a sector rotation as it is a change in investors' fundamental views of values of real estate assets. Compared to other commercial real estate asset classes, industrial appears to offer better yield with lower risk. This trend should continue throughout 2016, especially if borrowing rates remain low as forecast.




Source: Real Capital Analytics®, Lakemont Group

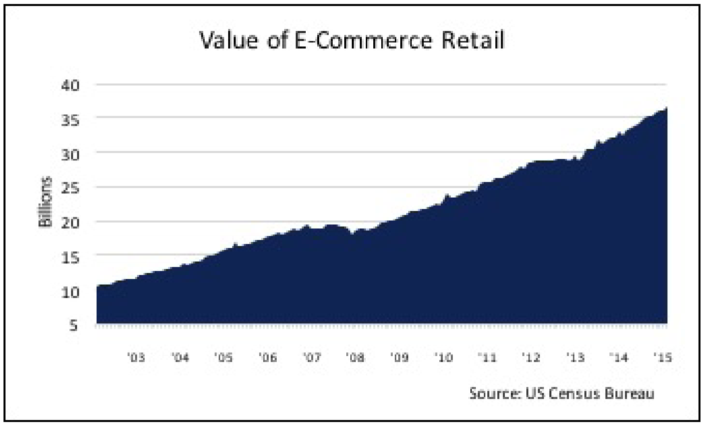
# Industrial Trend Watch

## WAREHOUSE IS THE STOREFRONT OF TOMORROW

The 2015 holiday season once again saw massive shifts of retail spending move from malls and physical storefronts to online orders, increasingly with delivery times as short as “same day.” This trend is most definitely going to continue as consumers enjoy the wide variety of choice not limited to store inventory and the convenience of free home delivery. While the rise of massive online retailers such as Amazon and eBay is not new, the reverse move of major physical store retailers, namely Walmart, to compete head to head in this space is new and relevant.

This is likely to have some profound, new impacts on commercial real estate. The first is the obvious and known decline of malls and big box retailers. The less obvious is the need for ever-increasing amounts of industrial distribution and warehouse space to fulfill the growing volume of online orders. Further, retailers (both online and traditional) are realizing that speed of delivery is every bit, if not more, important than pure price competition. This means that forces of competition will make retailers open distribution centers next to many, if not all, major population centers. Similar to two big box stores opening next door to each other, Amazon

next to many, if not all, major population centers. Similar to two big box stores opening next door to each other, Amazon and Walmart are opening distribution centers within a mile of each other to offer the same metropolitan region same day delivery. Suppliers to these firms now must locate accordingly close as well. This will be a huge boom of demand for industrial landlords and it is just barely beginning to take shape.



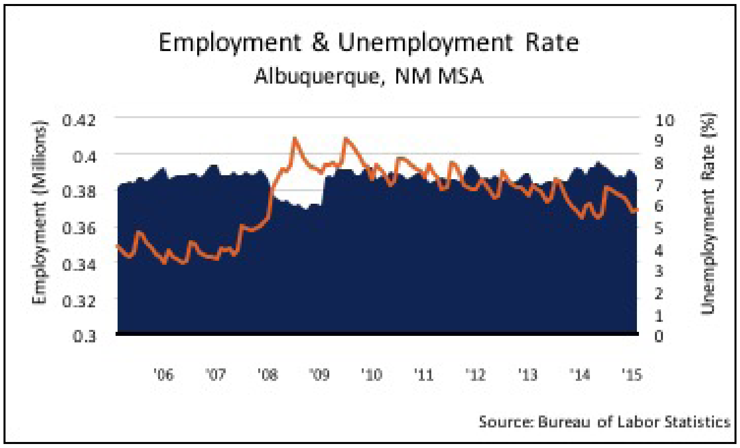

Source: Real Capital Analytics®, Lakemont Group

# MARKETS TO WATCH

Not necessarily the largest or the most actively contested markets, the 2016 Industrial Markets to Watch are each at an important juncture that presents unique opportunities for investment. Together, they reflect the diversity of trends that is driving the economy and commercial real estate performance in markets across the country.

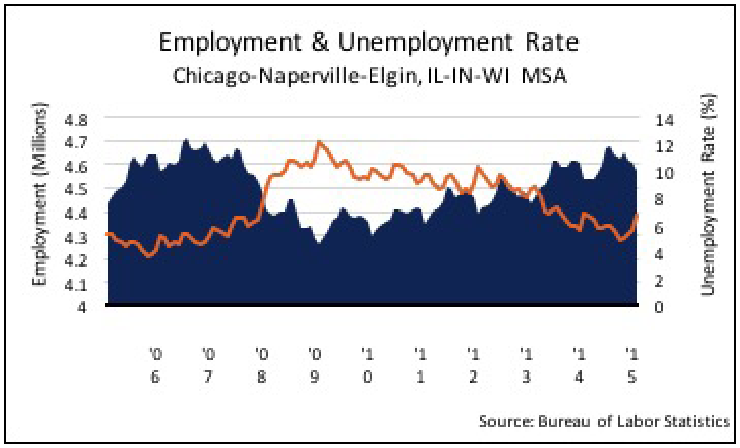
## ALBUQUERQUE, NM

Albuquerque's overall economy has remained fairly stable with a slowly falling, above national average level of unemployment at 5.8% as of January '16, according to the Bureau of Labor Statistics. Key industrial sectors have been losing employees and thus may threaten to soften the industrial space market; these include Manufacturing and Trade, Transportation, and Utilities which are contracting at –2.5% and –0.9% annualized rates, respectively. As much of the economic and industrial base of Albuquerque centers on high tech, research, defense, and other manufacturing, the industrial sector should remain very stable on a relative basis. Given low levels of new supply, growth in fundamentals could also occur in 2016 as the market is not over-supplied.




## CHICAGO, IL

Chicago has experienced a reversal in its unemployment rate, moving upward to 6.7% in January of '16 from recent lows in the 5% range in 2015. The industrial sector has been relatively stable and growing, with key industries such as Construction and Trade, Transportation, and Utilities growing at 5.8% and 1.3% annualized rates, respectively. Manufacturing remains flat at –0.2% annualized growth. Chicago industrial space is growing as vacancy falls while new space is being added. Given the location of Chicago and its linkages of rail, airport, and river, it is a natural point for distribution to much of the United States. Hence, it should benefit from the e-commerce growth discussed herein. The risk facing the Chicago industrial market comes from its amount of heavy industrial manufacturers that could lose demand in a global slowdown or face competition due to a strong US dollar.



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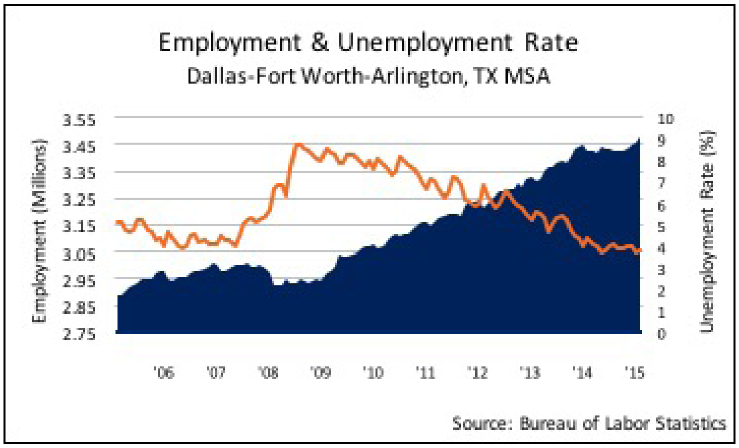
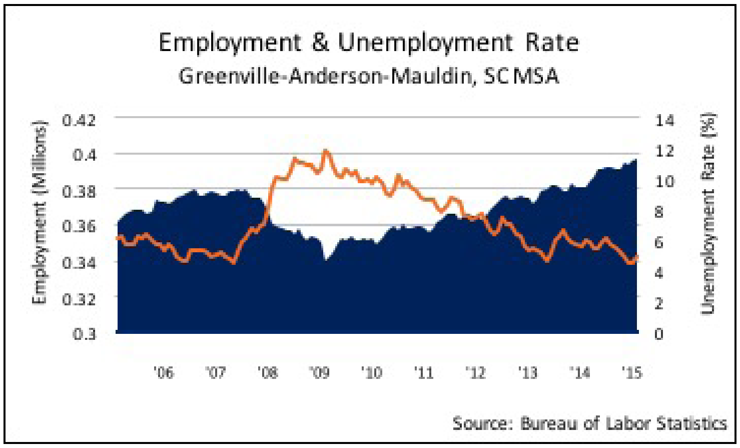
## DALLAS, TX

The Dallas economy remains one of the strongest of the major metros in the nation with unemployment at 3.8% as of January '16 and steadily rising total employment at a 3.4% annualized rate, according to the Bureau of Labor Statistics. The fastest growing sector of employment in Dallas is an industrial space using Trade, Transport, and Utilities, which is growing at an annualized rate of 5.2%. This is the sector, where most of the 2016 and beyond gains in the industrial space market will be generated. Dallas has unparalleled airport and rail access making it an ideal business and distribution hub. In fact, the area surrounding the DFW airport is best poised to expand. Manufacturing is the weakest sector declining at a –1.6% annualized rate. This sector touches oil and gas production and exploration, and is thus most at risk for declines in 2016 and beyond.



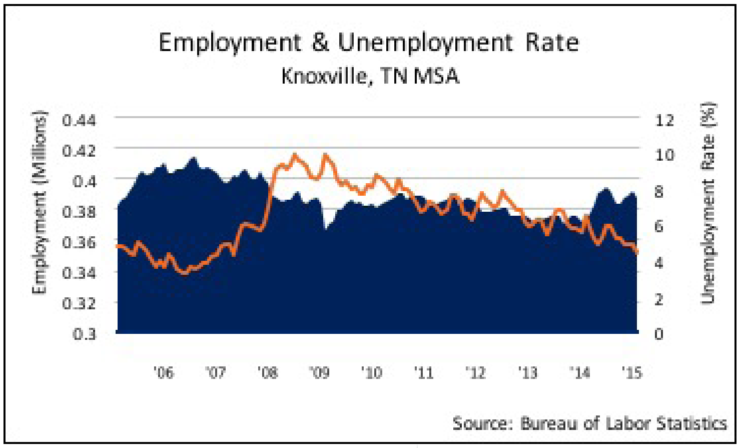

## GREENVILLE-SPARTANBURG, SC

The Greenville-Spartanburg region has experienced significant gains in its labor force, and overall employment is growing at a 2.6% annualized rate with unemployment holding steady at 4.9%, according to the Bureau of Labor Statistics. Key industrial sectors of Trade, Transport, and Utilities and Manufacturing are growing at annualized rates of 2.6% and 1.3%, respectively, setting up the industrial market for gains in 2016 and beyond. As South Carolina is well located for distribution in the Southeast, connected to ports, and unfriendly to labor unions, it is likely to continue to see expansion in its industrial sectors including those of Greenville-Spartanburg. Low cost of living and operating costs also serve to boost overall business development.



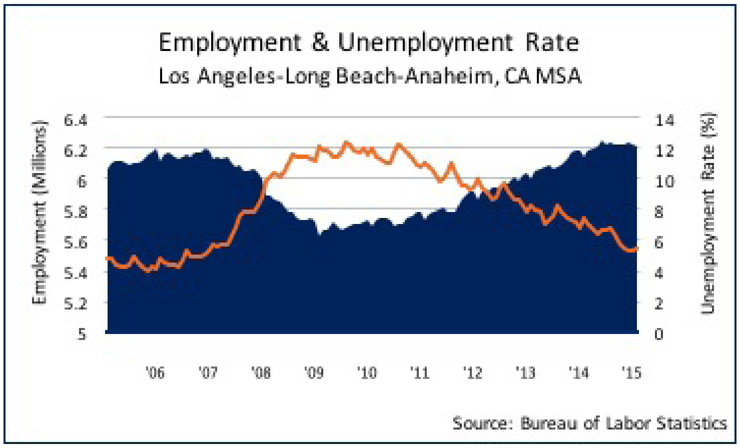

## KNOXVILLE, TN

The Knoxville economy is extremely steady given its diverse economic base and thus experienced relatively low effects of the recession. The city now has a 4.5% unemployment rate as of January '16, with overall employment growing at an annualized rate of 2.5%, according to the Bureau of Labor Statistics. The industrial sectors of Knoxville are all showing marked strength, including Manufacturing and Trade, Transport, and Utilities growing at annualized rates of 4.5% and 4.1%, respectively. Additionally, the Mining, Logging, and Construction sector is growing at a rapid 10.2% annualized rate, further fueling the market. The mix of defense, research, and industrial manufacturers gives Knoxville strong power to grow its industrial real estate in 2016 and beyond.



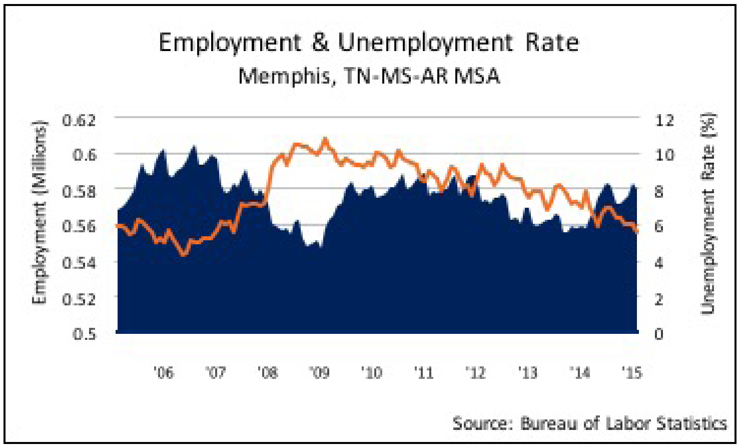
## LOS ANGELES, CA

Los Angeles is one of the largest, most dynamic cities in the United States and its economy has fully recovered, with a normalized level of unemployment at 5.5% as of January '16 and annualized total employment growth of 2.3%, according to the Bureau of Labor Statistics. Its industrial space market is one of the best performing in the nation due to the growth in container and freight traffic from the port as well as inbound air cargo from Asia. The Trade, Transportation, and Utilities sector is growing at an annualized rate of 1.7%, meaning that further growth and expansion is possible. Of course, the reliance on trade could cause a contraction in the industrial sector with global pressures, but this is unlikely as much of the trade and distribution are import goods that will benefit from a strong US dollar.



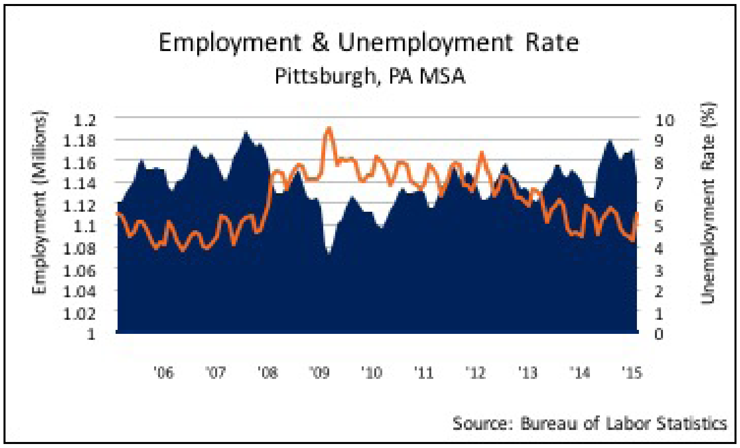

## MEMPHIS, TN

The Memphis economy has been slowly growing and recovering since the recession and stands today with 5.6% unemployment as of January '16, with modest annualized job gains of 1.7%, according to the Bureau of Labor Statistics. Its strongest industrial segment and in fact strongest employment segment overall is Trade, Transport, and Utilities, which is expanding at an annualized rate of 4.2%. Manufacturing is also adding jobs at 0.7%. Given that Memphis is located in the approximate population weighted center of the country, it is an ideal location to serve for e-commerce and other direct to consumer distribution businesses. Thus, the Memphis industrial market may be one of the largest benefactors of the rise of online shopping and will likely continue to expand in 2016 and beyond.




## PITTSBURGH, PA

The Pittsburgh economy has more or less stabilized after the recession and massive losses to its manufacturing and steel production base. Today the unemployment rate sits at 5.5% as of January '16 but job creation is effectively flat at a literal 0.0% rate of growth. The industrial real estate market of Pittsburgh is highly influenced by oil and gas production as well as the steel industry, both of which have potential to see long-term losses. Key industrial sectors are losing jobs, including Manufacturing and Trade, Transportation, and Utilities which are declining at annualized rates of –3.4% and –0.4%, respectively. Thankfully, Pittsburgh is transforming itself into a more research and high-tech focused economy which should grow overall jobs and ultimately benefit the industrial sector. Further, this trend should cause more vacant industrial buildings to be repurposed and redeveloped, helping industrial landlords overall.



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## SEATTLE, WA

Seattle has experienced significant job growth since the recession and continues to add jobs at an annualized rate of 3.0% keeping unemployment stable at 5.6% as of January '16, according to the BLS. As Seattle hosts major West Coast ports, a major airport, and excellent rail linkages, trade and distribution activities dominate the industrial real estate market. Employment in the Trade, Transportation, and Utilities sector is growing at an annualized rate of 4.2%, making up for losses in the Manufacturing sector that is contracting at an annualized rate of –0.9%. Overall, the Puget Sound ports and infrastructure should drive robust demand for industrial real estate as more and more ship traffic is routed up north from congested Long Beach, California.


## ST. LOUIS, MO

The St. Louis economy has experienced strong growth since the recession and now features a 5.2% unemployment rate as of January '16 with modest job growth of 1.2% annualized. The diverse economic base includes manufacturing of food and agricultural products that are relatively immune to cyclical forces and thus stabilize the St. Louis industrial space market. Still, the key industrial sector of Manufacturing is losing jobs at a 1.3% annualized pace while Trade, Transportation, and Utilities grows at a nearly flat rate of 0.3% annualized. Overall, the stable nature of the industries operating in St. Louis, many with corporate HQs, and its strong river, rail, and air linkages should allow its industrial market to remain healthy in 2016 and beyond.